DIGITAL POWER CORP

FORM 10KSB

(Annual Report (Small Business Issuers))

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Sector	Technology
Fiscal Year	12/31

U.S. SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-KSB

(Mark One)

[X] ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2000

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

DIGITAL POWER CORPORATION

(Exact name of registrant as specified in its charter)

California	3679	94-1721931
(State or other jurisdiction of incorporation or organization)	(Primary Standard Industrial Classification Code)	(I.R.S. Employer Identification No.)

41920 Christy Street, Fremont, California 94538-3158; 510-657-2635
(Address and telephone number of principal executive offices)

Securities registered under Section 12(b) of the Exchange Act:

Title of Each Class Name of Each Exchange on Which Registered
Common Stock American Stock Exchange

Securities registered under Section 12(g) of the Exchange Act:

Title of Each Class
None

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934, during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-B is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. [ ]

Revenues for the year ended December 31, 2000, were $17,882,730.

As of March 15, 2001, the aggregate market value of the voting common stock held by non-affiliates was approximately $4,857,120 based on the closing price of $1.50 per share.

As of March 15, 2001, the number of shares of common stock outstanding was 3,260,680.

Transitional Small Business Disclosure Format (check one): Yes No x

With the exception of historical facts stated herein, the following discussion may contain forward-looking statements regarding events and financial trends which may affect Digital Power's future operating results and financial position. Such statements are subject to risks and uncertainties that could cause Digital Power's actual results and financial position to differ materially from those anticipated in such forward-looking statements. Factors that could cause actual results to differ materially include, in addition to other factors identified in this report, a high degree of customer concentration, the loss of a key customer, dependence on the computer and electronic equipment industries, competition in the power supply industry, dependence on Guadalajara, Mexico facility, and dependence on key personnel, all of which factors are set forth in more detail in the sections entitled "Certain Considerations" and "Management's Discussion and Analysis or Plan of Operation" herein. Readers of this report are cautioned not to put undue reliance on "forward looking" statements which are, by their nature, uncertain as reliable indicators of future performance. Digital Power's disclaims any intent or obligation to publicly update these "forward looking" statements, whether as a result of new information, future events, or otherwise.

As used in this annual report, the terms "we," "us," "our," the "Company," "Digital" or "Digital Power" mean Digital Power Corporation and its subsidiaries unless otherwise indicated.

PART I.

Item 1. Description of Business

General

We are a California corporation originally formed in 1969. Our corporate office is located in Fremont, California. We have a manufacturing facility in Guadalajara, Mexico, and a design, manufacturing, and sales facility in Salisbury, England. We design, develop, manufacture, and sell 50 watt to 750 watt switching power supplies and DC/DC converters to original equipment manufacturers ("OEMs") of computers and other electronic equipment. Through our subsidiary Digital Power Limited, we also design, manufacture and sell uninterruptible power supplies, power conversion and distribution equipment for naval and military applications and DC/AC inverters primarily for the telecommunications industry in Europe under the label Gresham Power Electronics. Power supplies are critical components of electronic equipment that supply, convert, distribute, and regulate electrical power. The various subsystems within electronic equipment require a steady supply of direct current (DC) electrical power, usually at different voltage levels from the other subsystems within the equipment. In addition, the electronic components and subsystems require protection from the harmful surges and drops in electrical power that commonly occur over power lines.

Power supplies satisfy these issues of allocation and protection by (i) converting alternating current (AC) electricity into DC; (ii) by dividing a single input voltage into distinct and isolated output voltages; and (iii) by regulating and maintaining such output voltages within a narrow range of values.

Products which convert AC from a primary power source into DC are generally referred to as "power supplies." Products which convert one level of DC voltage into a higher or lower level of DC voltage are generally referred to as "DC/DC converters." "Switching" power supplies are distinguished from "linear" power supplies by the manner and efficiency with which the power supply "steps down" voltage levels. A linear power supply converts an unregulated DC voltage to a lower regulated voltage by "throwing away" the difference between the two voltages as heat. Consequently, the linear power supply is inherently inefficient-typically only 45% efficient for a 5V output regulator. By contrast, a switching power supply converts an unregulated DC voltage to a lower regulated voltage by storing the difference in a magnetic field. When the magnetic field grows to a pre-determined level, the unregulated DC is switched off and the output power is provided by the energy stored in the magnetic field. When the field is sufficiently depleted, the unregulated DC is switched on again to deliver power to the output while the excess voltage is again stored in the magnetic field. As a result, the switching power supply is more efficient-typically 75% efficient for a 5V output regulator.

One of the great advantages of switching power supplies, in addition to the high efficiency, is their high power density, or power-to-volume ratio. This density is the result of the reduction in the size of the various components. Our switching power supply products have a high power density and are generally smaller than those of competitors. For example, to the best of our knowledge our US100 series of power supplies, when originally introduced on a 3"x 5" printed circuit board, was the smallest 100 watt off-line (AC input) power supply available in the industry.

Another advantage of our power supply products is the extreme flexibility of design. We have designed the base model power supply products so that they can be quickly and inexpensively modified and adapted to the specific power supply needs of any OEM. This "flexibility" approach has allowed us to provide samples of modified power supplies to OEM customers in only a few days after initial consultation, an important capability given the emphasis placed by OEMs on "time to market." This "flexibility" approach also results in very low non-recurring engineering (NRE) expenses. Because of reduced NRE expenses, we do not charge our OEM customers for NRE related to tailoring a power supply to a customer's specific requirements. This gives us a distinct advantage over our competitors, many of whom do charge their customers for NRE expenses. Our marketing strategy is to exploit this combination of high power density, design flexibility, and short time-to-market to win an increasing share of the growing power supply market.

In addition to the line of proprietary products offered, and in response to requests from OEMs, we also provide "value-added services." The term "value-added services" refers to our incorporation of an OEM's selected electronic components, enclosures, and cable assemblies with our power supply products to produce a power subassembly that is compatible with the OEM's own equipment and specifically tailored to meet the OEM's needs. We purchase parts and components that the OEM itself would otherwise attach to or integrate with our power supply, and we provide the OEM with that integration and installation service, thus saving the OEM time and money. We believe that this value-added service is well-suited to those OEMs who wish to reduce their vendor base and minimize their investment in manufacturing which leads to increased fixed costs. Based on the value-added services, the OEMs do not need to build assembly facilities to manufacture their own power subassemblies and thus are not required to purchase individual parts from many vendors.

We are a California corporation originally formed in 1969 through a predecessor. Unless the context indicates otherwise, any reference to "Digital Power" herein includes our wholly-owned Mexican subsidiary, Poder Digital S.A. de C.V. and our wholly-owned United Kingdom subsidiary, Digital Power Limited, dba Gresham Power Electronics. Further, unless otherwise indicated, reference to dollars in this report shall mean United States dollars.

Digital Power Limited

In 1998, we acquired the assets of Gresham Power Electronics. Our wholly-owned subsidiary, headquartered in Salisbury, England, Digital Power Limited designs, manufactures, and distributes switching power supplies, uninterruptible power supplies, and frequency converters for the commercial and military markets under the name Gresham Power Electronics. Uninterruptible power supplies (UPS) are devices that are inserted between a primary power source and the primary power input of the electronic equipment to be protected for the purpose of eliminating the effects of transient anomalies or temporary outages. A UPS consists of an inverter that is powered by a battery that is kept trickle-charged by rectified AC from an incoming power line. In the event of a power interruption, the battery takes over without the loss of even a fraction of a cycle in the AC output of the UPS. The battery also provides protection against transients. A frequency converter is an electronic unit for speed control of a phase induction motor. The frequency converters manufactured by Digital Power Ltd. are used to convert a warship's generated 60 cycle electricity supply to 400 cycles. This 400 cycle supply is used to power critical equipment such as the ship's gyro, compass and weapons systems. The acquisition of Gresham Power Electronics has diversified our product line, provided greater access to the United Kingdom and European markets, and strengthened our engineering and technical resources. For the year ended December 31, 2000, Digital Power Limited contributed approximately 30% to our gross revenues.

The Market

Since virtually all electronic equipment requires power supplies, the overall market for power supplies is very large. The growth of the power supply industry has paralleled that of the general electronics industry. Since 1994, growth has escalated at an even faster pace, fueled by the demand for networking communications equipment and computing equipment and its peripherals. Future growth is expected to come from the same markets, as internet and intranet networking and cellular and digital telephones continue to become popular around the world.

The electronic power supply market is typically split into "captive" and "merchant" market segments. The captive segment of the market is represented by OEMs who design and manufacture power supplies for use in their own products. The remaining power supply market is served by merchant power supply manufacturers, such as Digital Power, that design and manufacture power supplies for sale to OEMs.

We believe that the merchant market is the fastest growing segment of the power supply market, as OEMs continue to outsource their power supply requirements. We believe that this increase is due, in part, to the fact that power supplies are becoming an increasingly complex component in the eyes of OEMs, with constantly changing requirements such as power factor correction (PFC) and filtering specifications to minimize electromagnetic interference (EMI).

The power supply market can also be divided between "custom" and "standard" power supplies. Custom power supplies are those that are customized in design and manufactured with a specific application in mind, whereas standard power supplies are sold off-the-shelf to customers whose electronic equipment can operate from standard output voltages such as 5, 12, or 24 volts. Power supplies in the captive market that are designed and manufactured by an OEM for use in its own equipment are an example of a custom design, as the product is not intended for resale. However, custom power supplies are also common in the merchant market, as certain OEMs contract with power supply manufacturers to design a product that meets the form, fit, and function requirements of that OEM's specific application. A subset of the standard segment of the market has evolved, commonly known as the "modified standard" segment, comprising power supply products that have the performance characteristics of a standard power supply, but require certain, usually minor, modifications. These modifications typically involve an adjustment to one of the standard output voltages, such as from 5 volts to 7 volts, or from 15 volts to 18.5 volts.

The power supply industry is highly fragmented. There are approximately 300 domestic merchant power supply competitors in the United States, with over 200 that generate less than $5 million in revenues. No one manufacturer holds more than ten percent of the total market. The merchant market segment is also highly fragmented according to the power level, technology, packaging, or application of a merchant's particular power supply. Most merchant manufacturers concentrate on niche markets, whether power ranges or industry segments.

With no industry standards for power supplies, it is very difficult to design out an existing power supply component, which prevents large companies from quickly gaining market share. The key to being a profitable manufacturer is to have long-term expertise in power electronics and to be able to provide products needed by customers. We have targeted and serve the industrial and office automation, industrial and portable computing, and networking applications niches of the merchant market. We believe that our focus on high-efficiency, high-density, design-flexible power supplies is ideally suited to the rapid growth opportunities existing in this market segment.

Geographically, we primarily serve the North American power electronics market with AC/DC power supplies and DC/DC converters ranging from 50 watts to 750 watts of total output power. Digital Power Ltd. serves the United Kingdom and the European marketplace with AC/DC power supplies, uninterruptible power supplies, and frequency inverters. Both commercial and government (Ministry of Defense) markets are served by Digital Power Ltd.

Customers

Our products are sold domestically and in Canada through a network of 14 manufacturers' representatives. We also have 23 stocking distributors in the United States and Europe. In addition, we have formed strategic relationships with three of our customers to private label our products. Our customers can generally be grouped into three broad industries, consisting of the computer, telecommunication, and instrument industries. We have a current base of over 150 active customers, including companies such as Telex, Dot Hill, Motorola, Extreme Networks, Foundry Networks, JDS Uniphase, Ericsson, British Telecom and Lucent.

Gresham Power Electronic products are sold primarily in the United Kingdom and to a lesser extent in Europe. Our customers in Europe include the United Kingdom Ministry of Defense, Vosper Thorney Croft, Emerson and Seimens.

Strategy

Our strategy is to be the supplier of choice to OEMs requiring a high-quality power solution where size, rapid modification, and time-to-market are critical to business success. Target market segments include telecommunications, networking, switching, mass storage, and industrial and office automation products. While many of these segments would be characterized as computer-related, we do not participate in the personal computer (PC) power supply market because of the low margins arising out of the high volume and extremely competitive nature of that market.

We intend to continue our sales primarily to existing customers while simultaneously targeting sales to new customers. We believe that our "flexibility" concept allows customers a unique choice between our products and products offered by other power supply competitors. OEMs have typically had to settle for a standard power supply product with output voltages and other features predetermined by the manufacturer. Alternatively, if the OEM's product required a different set of power supply parameters, the OEM was forced to design this modification in-house, or pay a power supply manufacturer for a custom product. Since custom-designed power supplies are development-intensive and require a great deal of time to design, develop, and manufacture, only OEMs with significant volume requirements can economically justify the expense and delay associated with their production. Furthermore, since virtually every power conversion product intended for use in commercial applications requires certain independent safety agency testing at considerable expense, such as by Underwriters Laboratories, an additional barrier is presented to the smaller OEM. By offering OEM customers a new choice with Digital Power "flexibility" series, we believe we have an advantage over our competitors. Our "flexibility" series is designed around a standardized power platform, but allows the customer to specify output voltages tailored to its exact requirements within specific parameters. Furthermore, OEMs are seeking power supplies with greater power density and higher efficiency. Digital Power's strategy in responding to this demand has been to offer increasingly smaller power supply units or packages.

Product Strategy and Products

We have ten series of base designs from which thousands of individual models can be produced. Each series has its own printed circuit board (PCB) layout that is common to all models within the series regardless of the number of output voltages (typically one to four) or the rating of the individual output voltages. A broad range of output ratings, from 2.0 volts to 48 volts, can be produced by simply changing the power transformer construction and a small number of output components. Designers of electronic systems can determine their total power requirements only after they have designed the system's electronic circuitry and selected the components to be used in the system. Since the designer has a finite amount of space for the system and may be under competitive pressure to further reduce its size, a burden is placed on the power supply manufacturer to maximize the power density of the power supply. A typical power supply consists of a PCB, electronic components, a power transformer and other electromagnetic components, and a sheet metal chassis. The larger components are typically installed on the PCB by means of pin-through-hole assembly where the components are inserted into pre-drilled holes and soldered to electrical circuits on the PCB. Other components can be attached to the PCB by surface mount interconnection technology (SMT) which allows for a reduction in board size since the holes are eliminated and components can be placed on both sides of the board. Our US100 series is an example of a product using this manufacturing technology.

Digital Power's "flexibility" concept applies to all of our US, UP/SP, DP and UPF product series. A common printed circuit board is shared by each model in a particular family, resulting in a reduction in parts inventory while allowing for rapid modifiability into thousands of output combinations. The following is a description of our products.

The US50 series of power supplies consists of compact, economical, high efficiency, open frame switchers that deliver up to 50 watts of continuous power, or 60 watts of peak power, from one to four outputs. The 90-264 VAC universal input allows them to be used worldwide without jumper selection.

Flexibility options include power good signal, an isolated V4 output, and UL544 (medical) safety approval. All US50 series units are also available in 12VDC, 24VDC, or 48VDC inputs. This optional DC input unit (DP50 series) maintains the same pin-out, size, and mounting as the US50 series.

The US70 series of power supplies is similar to the US50 series, a compact, economical, highly efficient, open frame switcher that delivers up to 65 watts with a 70 watt peak. This unit is offered with one to four outputs, a universal input rated from 90 to 264 VAC, and is only slightly larger than the US50 series. The US70 series is differentiated from competitive offerings by virtue of its smaller size, providing up to four outputs while competitors typically are limited to three outputs. Flexibility options include cover, power good signal, an isolated V4 output, and UL544 (medical) safety approval. The DP70 is the same as the US70 except the input is 48 volts DC. We also offer 12 & 24VDC DC input on this series where the model series changes to DN & DM. This type of product is ideal for low profile systems, with the power supply measuring 3.2" x 5" x 1.5".

The US100/DP100 is the industry's smallest 100 watt switcher. Measuring only 5" x 3.3" x 1.5", this series delivers up to 100 watts of continuous power, or 120 watt peak power, from one to four outputs. The 90-264VAC universal input allows them to be used worldwide. This product is ideal in applications where OEMs have upgraded their systems, requiring an additional 30-40 watts of output power but being unable to accommodate a larger unit. The US100 fits in the same form factor and does not require any tooling or mechanical changes by the OEM. Flexibility options include a cover and adjustable post regulators on V3 and/or V4 outputs. Fully customized models are also available. All US100 series units are also available with 12VDC, 24VDC, or 48 VDC inputs. This optional DC input unit (DP100) maintains the same pin-out, size, and mounting as the US100 series.

The UP300 series consists of economical, high efficiency, open frame switchers that deliver up to 300 watts of continuous, or 325 watts of peak power, from one or two outputs. The 115/230VAC auto- selectable input allows them to be used worldwide. On-board EMI filtering is a standard feature. Flexibility options include a cover, power fail/power good signal, and an isolated 2nd output. The UP300 is also available as the SP300 series, which is jumper selectable between 115 and 230VAC and provides the OEM an even more economical solution. This product can be used in network switching systems or other electronic systems where a lot of single output current, such as 5, 12, 24, or 48 volt current might be required.

The US250 series consists of economical, high efficiency, open frame switchers that deliver up to 250 watts of continuous power, or 300 watts of peak power, from one to four outputs. The 115/230VAC auto-selectable input allows them to be used worldwide. Flexibility options include cover, power fail/power good signal, enable/inhibit, and an isolated V3 output. All US250 series units are also available with 12VDC, 24VDC, or 48VDC inputs. This optional DC input unit (DP250) maintains the same pin- out, size, and mounting as the US250 series.

The US350 series is a full-featured unit that has active power factor correction and was designed to be field-configurable by our international and domestic sales channels. This feature allows the stocking distributor to lower its inventory costs but still maintain the required stock to rapidly provide power supplies with the unique combination of output voltages required by an OEM. This unit delivers 350 watts from one to four output modules and meets the total harmonic distortion spec EN 61000-3-2. The US350 has an on-board EMI filter and operates from 90-264 VAC input. This unit measures 9" x 5" x 2.5". It can operate without any minimum loads and has an optional internal fan and power fail/power good signal.

Two of our newer products are the UPF 150 and UPF 300 series. The UPF 150 is an open-frame switcher that delivers up to 150watts of continuous power from one to four outputs. The UPF 150 is endowed with power factor correction and a Class B EMI filter, making the series particularly well-suited for those customers selling into the international market place. Also incorporating active power factor correction, the UPF 300 delivers up to 300 watts from one or two outputs and measures 8" x 4.5" x 2".

We offer our customers various types of value-added services, which may include the following additions to their standard product offerings:

Electrical (power): Paralleled power supplies for (N+1) redundancy, hot swapability, output OR'ing diodes, AC input receptacle with fuse, external EMI filter, on/off switch, cabling and connectors, and battery backup with charger.

Electrical (control and monitoring): AC power fail detect signal, DC output(s) OK signal, inhibit, output voltage margining, and digital control interface.

Mechanical: Custom hot-plug chassis for (N+1) redundant operation, locking handle, cover, and fan.

These services incorporate one of our base products along with additional enclosures, cable assemblies, and other electronic components to arrive at a power subassembly. This strategy matches with those OEMS wishing to reduce their vendor base, as the turnkey sub-assembly allows customers to eliminate other vendors.

Other than certain fabricated parts such as printed circuit boards and sheet metal chassis which are readily available from many suppliers, we use no custom components. Typically, two suppliers are qualified for every component, with the exception being one line transformer manufactured by Spitznagel. This transformer is designed into one of our products, which accounted for less than 5% of our total sales in 2000.

Gresham Power Electronics' primary product lines include the following:

Military Power Supplies. Design and manufacture of AC and DC power conversion equipment which is intended for naval and other applications where arduous duties demand quality and reliability. Products include transformer rectifier units to 15KVA and Static Frequency Converters to 5KVA.

Commercial Component Power Supplies. Distribution and service of all Digital Power's product lines to non-American markets.

Uninterruptible Power Supplies. Distribution and service of uninterruptible power supplies mainly to the United Kingdom telecommunications industry. Products offered range from 250VA to 100KVA but main market is up to 10KVA.

Telecommunications Inverters. Design and manufacture of DC to AC sine-wave inverters. Rugged equipment intended for use in remote areas for the support of mobile telecommunications installations.

Manufacturing Strategy

Consistent with our product flexibility strategy, we aim to maintain a high degree of flexibility in our manufacturing processes in order to respond to rapidly changing market conditions. With few exceptions, the competitive nature of the power supply industry has placed continual downward pressure on selling prices. In order to achieve low cost manufacturing with a labor-intensive product, manufacturers have the option of automating much of the labor out of their product, or producing their product in a low labor cost environment. Given the high fixed costs of automation and the resistance this places on making major product changes, we believe that our flexible manufacturing strategy is best achieved through a highly variable cost of operation. In 1986, we established a wholly-owned subsidiary in Guadalajara, Mexico to assemble our products. This manufacturing facility performs materials management, sub-assembly, final assembly, and test functions for the majority of our power supply products. Currently, almost all of our manufacturing, including our value-added services, is done at a 16,000 square foot facility operated by our wholly-owned subsidiary, Poder Digital, S.A. de C.V., located in Guadalajara, Mexico. In addition, we have entered into an agreement with Fortron/Source Corp. to manufacture our products at a facility located in China on a turnkey basis. Purchases from Fortron/Source will be made pursuant to purchase orders and the agreement may be terminated upon 120 days notice. We are manufacturing approximately 20% of our product requirements through Fortron/Source and expect to increase these production levels due to cost advantages achieved through Chinese procurement. We believe that the facility in China complements our manufacturing facility in Guadalajara, Mexico since the facility in China allows us to produce power supplies with sufficient lead time at lower costs, while the Guadalajara facility will continue to manufacture power supplies that need a quick turnaround or modification.

Digital Power Limited Manufacturing

Digital Power Limited is ISO9001-1 certified and operates from a 25,000 sq. ft leased facility located in Salisbury U.K.

The products manufactured in Salisbury are physically quite different from those produced in Guadalajara, but the factory is organized on similar lines; where all procurement of component parts is out- sourced with only final assembly, test and quality assurance taking place in-house.

Sales and service support staff for the European network of distributors for Digital Power products are located within the building together with other functions such as Engineering and Administration. The company operates a fully integrated production control and accounting system.

Sales, Marketing and Customers

During 2000, we had revenues of $17,882,730 and net income of $95,167, compared to revenues of $15,354,018 and net income of $33,427 during fiscal year 1999.

Digital Power markets its products through a network of thirteen domestic and one Canadian independent manufacturers' representatives. Each representative organization is responsible for managing sales in a particular geographic territory. Generally, the representative has exclusive access to all potential customers in the assigned territory and is compensated by commissions at 5% of net sales after the product is shipped, received, and paid for by the customer. Typically, either we or the representative organization may terminate the agreement with 30 day's written notice.

In certain territories, we have entered into agreements with 23 stocking distributors who buy and resell our products. For the fiscal years ended December 31, 2000 and 1999, distributor sales accounted for 31.6% and 22.7%, respectively, of our total sales. Over this same period, one distributor accounted for 11.6% and 10.9%, respectively, of total sales. In addition, international sales through stocking distributors accounted for less than 5% of our sales. In general, the agreements with stocking distributors are subject to annual renewal and may be terminated upon 90 days' written notice. Although these agreements may be terminated by either party in the event a stocking distributor decides to terminate its agreement with us, we believe that we would be able to continue the sale of our products through direct sales to the customers of the stocking distributor. Further, and in general, stocking distributors are eligible to return 25% of their previous six-months' sales for stock rotation. For the past three years, stock rotations have not exceeded one percent of total sales.

We have also entered into agreements with two private label customers who buy and resell our products. Under these agreements, we sell our products to the private label company who then resells the products with its label to its customers. We believe that these private label agreements expand our market by offering the customer a second source for our products. The private label agreements may be terminated by either party. Further, the private label agreement requires that any product subject to a private label be available for five years. For the years ended December 31, 2000 and 1999, private label sales accounted for 3.1% and 3.7%, respectively, of total sales.

Our promotional efforts to date have included product data sheets, feature articles in trade periodicals, and trade shows. Our future promotional activities will likely include space advertising in industry-specific publications, a full-line product catalog, application notes, and direct mail to an industry-specific mail list.

Our products are warranted to be free of defects for a period ranging from one to two years from date of shipment. No significant warranty returns were experienced in either 2000 or 1999. As of December 31, 2000 and 1999, our warranty reserve was $266,451 and $212,782, respectively.

Competition

The merchant power supply manufacturing industry is highly fragmented and characterized by intense competition. Our competition includes over 500 companies located throughout the world, some of whom have advantages over us in terms of labor and component costs, and some of whom may offer products comparable in quality to ours. Many of our competitors, including PowerOne, Artesyn Technologies, Inc., ASTEC America, Lambda Electronics, Westinghouse, Belix and American Power Conversion have substantially greater fiscal and marketing resources and geographic presence than we do. If we continue to be successful in increasing our revenues, competitors may notice and increase competition for our customers. We also face competition from current and prospective customers who may decide to design and manufacture internally the power supplies needed for their products. Furthermore, certain larger OEMs tend to contract only with larger power supply manufacturers. This factor could become more problematic to us if consolidation trends in the electronics industry continue and some of the OEMs to whom we sell our products are acquired by larger OEMs. To remain competitive, management believes that we must continue to compete favorably on the basis of value by providing advanced manufacturing technology, offering superior customer service and design engineering services, continuously improving quality and reliability levels, and offering flexible and reliable delivery schedules. We believe we have a competitive position with our targeted customers who need a high-quality, compact product which can be readily modified to meet the customer's unique requirements. However, there can be no assurance that we will continue to compete successfully in the power supply market.

Research and Development

Our research and development efforts are primarily directed toward the development of new standard power supply platforms which may be readily modified to provide a broad array of individual models. Improvements are constantly sought in power density, modifiability, and efficiency, while we attempt to anticipate changing market demands for increased functionality, such as PFC and improved EMI filtering. Internal research is supplemented through the utilization of consultants who specialize in various areas, including component and materials engineering and electromagnetic design enhancements to improve efficiency, while reducing the cost and size of our products. Product development is performed at our headquarters in California by three engineers who are supported and assisted by five technicians. Our total expenditures for research and development were $1,166,015 and $952,690 for the years ended December 31, 2000 and 1999, respectively, and represented 6.52% and 6.20% of our total revenues for the corresponding periods.

Employees

As of December 31, 2000, we had approximately 400 full-time employees, with 320 of these employed at our wholly-owned subsidiary Poder Digital located in Guadalajara, Mexico, and 50 employed by Digital Power Ltd. The employees of Digital Power's Mexican operation are members of a national labor union, as are most employees of Mexican companies. We have not experienced any work stoppages at any of our facilities and believe that our employee relations are good.

Guadalajara, Mexico Facility and Foreign Currency Fluctuations

We produce substantially all of our products at our 16,000 square foot facility located in Guadalajara, Mexico. The products are then delivered to Fremont, California for testing and distribution. We believe that we have a good working relationship with our employees in Guadalajara, Mexico and have recently signed a five-year contract with the union representing the employees. In 1997, we entered into a "turnkey" manufacturing contract with a manufacturer located in China to produce our products in an attempt to reduce our dependence on our Mexican facility. At this time the purchase of products from the manufacturer located in China accounts for approximately 20% of revenues and requires advance scheduling which affects our ability to produce products quickly. However, if our revenues grow as anticipated, we intend to manufacture more of our products utilizing the Chinese manufacturer. In the event that there is an unforeseen disruption at the Guadalajara production plant or with the Chinese manufacturer, such disruption may have an adverse effect on our ability to deliver our products and may adversely affect our financial operations.

Further, the Guadalajara, Mexico facility conducts its financial operations using the Mexican peso and Gresham Power conducts its financial operation using the United Kingdom pound. Therefore, due to financial conditions beyond our control, we are subject to monetary fluctuations between the U.S. dollar, Mexican peso, and United Kingdom pound.

CERTAIN CONSIDERATIONS

In addition to the other information presented in this report, the following should be considered carefully in evaluating us and our business. This report contains various forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from the results discussed in the forward-looking statements. Factors that might cause such a difference include, but are not limited to, those discussed below and elsewhere in this report.

We are dependent on a limited number of customers.

Traditionally, we have relied on a limited number of customers for growth in sales. For the year ended December 31, 2000, one OEM customer accounted for 11.6% of our total revenue. We cannot assure you that we will be able to retain current customers, and the loss of any major OEM customer may have an adverse effect on our revenues.

We have entered into a $3 million credit facility which is secured by all our assets.

We have a $3,000,000 line of credit pursuant to a promissory note agreement. This promissory note is secured by all of our assets. In the event we default under the promissory note, the bank may have the right to attach all of our assets which would adversely affect our operations.

DPL has a $500,000 line of credit pursuant to a loan agreement. In the event of a loan being used, the loan would be collateralized by substantially all of the DPL's assets. At December 31, 2000, no principal or accrued interest was outstanding.

We are dependant on computer and other electronic equipment industries

Substantially all of our existing customers are in the computer and other electronic equipment industries and manufacture products which are subject to rapid technological change, obsolescence, and large fluctuations in demand. These industries are further characterized by intense competition. The OEMs serving these markets are pressured for increased product performance and lower product prices. OEMs, in turn, make similar demands on their suppliers, such as us, for increased product performance and lower prices. The computer industry is inherently volatile. Recently, certain segments of the computer and other electronic industries have experienced a significant softening in product demand. Such lower demand may affect our customers, in which case the demand for our products may decline, our growth could be adversely affected.

We are dependent on the performance of our facility in Guadalajara, Mexico and manufacturer in China; Foreign currency risks

Substantially all of our products sold by Digital Power in the United States are produced at our facility located in Guadalajara, Mexico. We also have a "turnkey" manufacturing contract with a manufacturer located in China to produce our products in an attempt to reduce our dependence on our Mexican facility. For the years ended December 31, 2000 and 1999, the purchase of products from our manufacturer located in China accounts for approximately 20% of our revenues.

We are dependant upon key personnel

Our performance is substantially dependent on the performance of its executive officers and key personnel, and on its ability to retain and motivate such personnel. The loss of any of our key personnel, particularly Robert O. Smith, Chief Executive Officer, could have a material adverse effect on our business, financial condition and operating results. We have "key person" life insurance policies on Mr. Smith in the aggregate amount of $2 million.

We are dependant on suppliers

We rely on, and will continue to rely on, outside parties to manufacture parts, components and equipment. We cannot assure you that these suppliers will be able to meet our needs in a satisfactory and timely manner or that we will be able to obtain additional suppliers when and if necessary. A significant price increase, a quality control problem, an interruption in supply or other difficulties with third party manufacturers could have a material and adverse effect on our ability to successfully provide our products. Further, the failure of third parties to deliver the products, components, necessary parts or equipment on schedule, or the failure of third parties to perform at expected levels, could delay our delivery of power supply products. Recently, we have experience lengthening lead time and allocations of certain components, including tantalum capacitors and cores, and other surface mount technology parts.

Our products are not patentable

Our products are not subject to any U.S. or foreign patents. We believe that because our products are continually updated and revised, obtaining patents would be costly and not beneficial. Therefore, we cannot guarantee that other competitors or former employees will make use of and develop proprietary information on which we rely.

Our common stock price is volatile

Our common stock is listed on the American Stock Exchange and is thinly traded. In the past, our trading price has fluctuated widely, depending on many factors that may have little to do with our operations or business prospects.

The exercise of outstanding options and warrants may adversely affect our stock price and your percentage of ownership

As of December 31, 2000, options to purchase 938,720 shares of common stock, with a weighted average exercise price of $2.39 exercisable at prices ranging from $1.5625 to $6.25 per share were outstanding. The exercise of these options may have an adverse effect on the price of our common stock price and will dilute existing shareholder percentage ownership in us.

Item 2. Description of Properties.

Our headquarters are located in approximately 9,500 square feet of leased office, research and development space in Fremont, California. We paid $6,653 per month, subject to adjustment, and the lease expired on January 31, 2001. The Fremont California lease was renewed until January 31, 2004, with monthly rent increasing to $14,725 over the next three years. Our manufacturing facility is located in 16,000 square feet of leased space in Guadalajara, Mexico. We pay approximately $4,583 per month, subject to adjustment, and the lease expires in February 2001. The Guadalajara, Mexico lease was renewed to 2003 with monthly rent increasing to $6,400. Gresham Power leases approximately 25,000 square feet for its location in Salisbury, England. Gresham Power pays rent of approximately (pound)17,500 per quarter, and the lease will expire September 26, 2009. We believe that our existing facilities are adequate for the foreseeable future and have no plans to expand them.

Item 3. Legal Proceedings.

There currently is no legal proceeding pending involving the Company or its properties.

Item 4. Submission of Matters to a Vote of Security Holders.

None

PART II

Item 5. Market for Common Equity and related Stockholder Matters.

(a) Comparative Market Prices

Our common stock is listed and traded on the American Stock Exchange ("AMEX") under the symbol DPW. The following tables set forth the high and low closing sale prices, as reported by AMEX, for our common stock for the prior two fiscal years.

	Common Stock	
Quarter Ended	High	Low
December 31, 2000	$ 6.63	$1.50
September 20, 2000	14.94	2.25
June 30, 2000	3.63	2.00
March 31, 2000	4.81	1.69
December 31, 1999	1.94	1.25
September 20, 1999	2.06	1.5
June 30, 1999	2.06	1.38
March 31, 1999	$ 2.38	$1.31

(b) Holders

As of March 15, 2001, there were 3,260,680 shares of our common stock outstanding, held by approximately 121 holders of record, not including shareholders whose shares are held in street name.

(c) Dividends

We have not declared or paid any cash dividends since our inception. We currently intend to retain future earnings for use in the operation and expansion of the business. We do not intend to pay any cash dividends in the foreseeable future. The declaration of dividends in the future will be at the discretion of the Board of Directors and will depend upon our earnings, capital requirements, and financial position.

Item 6. Management's Discussion and Analysis or Plan of Operation.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

General

We are engaged in the business of designing, developing, manufacturing, and marketing electronic power supplies for use in electronic circuitry. Revenues are generated from the sale of our power supplies to distributors, OEMs in the computer and other electronic equipment industries, and the defense industry in the United Kingdom.

During the first quarter of fiscal year 2001, we have experienced a significant slow down in customer orders in the United States due to OEMs having excess inventories and softness in the marketplace. We anticipate that the slow down will continue throughout fiscal 2001. Therefore, we do not believe that we will achieve the same level of sales in the United States for the year ending December 31, 2001, as in the prior year.

Results of Operations

The table below sets forth certain statements of operations data as a percentage of revenues for the years ended December 31, 2000 and 1999.

	Years Ended December 31,	
	2000	1999
Revenues	100.00%	100.00%
Cost of goods sold	73.95	73.45
Gross margin	26.05	26.55
Selling, general and administrative	18.14	18.26
Research and development	6.52	6.20
Total operating expense	24.66	24.66
Operating income	1.39	2.09
Net interest expense	0.28	1.07
Income before income taxes	1.11	1.02
Provision for income taxes	0.58	0.80
Net Income	0.53%	.22%

The following discussion and analysis should be read in connection with the our consolidated financial statements and the notes thereto and other financial information included elsewhere in this report.

Year Ended December 31, 2000, Compared to Year Ended December 31, 1999

Revenues

For the year ended December 31, 2000, revenues increased by 16.47% to $17,882,730 from $15,354,018 for the year ended December 31, 1999. The increase in revenues during the year ended December 31, 2000, can be attributed primarily to significant increases in units shipped to five large United States OEM customers. For the year ended December 31, 2000, Digital Power Ltd. contributed $5,146,132 to our revenues compared to $6,469,617 for the year ended December 31, 1999.

Gross Margins

Gross margins were 26% for the year ended December 31, 2000, compared to 26.6% for the year ended December 31, 1999. The increase in gross margins can primarily be attributed to increased OEM business and manufacturing in China, as noted above.

Selling, General and Administrative

Selling, general and administrative expenses were 18.1% of revenues for the year ended December 31, 2000, compared to 18.3% for the year ended December 31, 1999. Increased selling, general and administrative expenses can be attributed primarily to an increased marketing staff, increased commissions paid and increased investor relations expenses.

Engineering and Product Development

Engineering and product development expenses were 6.5% of revenues for the year ended December 31, 2000, compared to 6.2% for the year ended December 31, 1999. The increases in engineering and product development expenses reflect our continuing commitment to new product development.

Interest Expense

Interest expense, net of interest income, was 0.3% for the year ended December 31, 2000, compared to 1.1% for the year ended December 31, 1999. The decrease in interest expense is primarily due to reduced borrowing on our line of credit, which was $400,000 at December 31, 2000, and replacement of Digital Power Ltd. receivables financing with a bank line of credit with a more favorable interest rate.

Income Before Income Taxes

For the year ended December 31, 2000, we had income before income taxes of $199,167 compared to $156,427 for the year ended December 31, 1999.

Income Tax

The provision for income tax decreased to $104,000 for the year ended December 31, 2000 from $123,000 for the year ended December 31, 1999.

Net Income

Net income for the year ended December 31, 2000, was $95,167, compared to a net income of $33,427 for the year ended December 31, 1999. The increase in net income is due to increased revenues for the year, primarily related to increased marketing efforts of our United States operations and increased profits from our foreign subsidiaries.

Liquidity And Capital Resources

On December 31, 2000, we had cash of $806,407 and working capital of $6,461,665. This compares with cash of $824,708 and working capital of $5,367,917 at December 31, 1999. The increase in working capital was due to an increase in accounts receivable, inventory, and prepaid expenses, and decrease of accrued liabilities, offset by a decrease in other receivables and increase in accounts payable resulting in a decrease in cash and cash equivalents. Cash provided by operating activities totaled $178,499 and $1,728,208 for the year ended December 31, 2000 and 1999.

Cash used in investing activities was $149,947 for the year ended December 31, 2000, compared to $161,896 for the year ended December 31, 1999. Net cash provided by (used in) financing activities was $151,771 for the year ended December 31, 2000, compared to $(1,524,302).

Impact of Recently Issued Standards

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133 "Accounting for Derivative Instruments and Hedging Activities," (FASB133). FASB133 requires that an entity recognize all derivatives as assets or liabilities in the statement of financial position and measure those instruments at fair value. This statement was amended by Statement of Financial Accounting Standards No. 137, issued in June 1999, such that it is effective for our financial statements for the year ending December 31, 2001. We do not believe the adoption of FASB133 will have a material impact on assets, liabilities or equity. We have not yet determined the impact of FASB133 on the income statement or the impact on comprehensive income.

In December 1999, the Securities and Exchange Commission (SEC) released Staff Accounting Bulletin 101 (SAB 101) "Revenue Recognition in Financial Statements." SAB 101 establishes guidelines in applying generally accepted accounting principles to the recognition of revenue in financial statements based on the following four criteria: persuasive evidence that an arrangement exists, delivery has occurred or services have been rendered, the seller's price to the buyer is fixed or determinable, and collectibility is reasonably assured. SAB 101, as amended by SAB 101A and SAB 101B, is effective no later than the fourth fiscal quarter of the fiscal years beginning after December 15, 1999, except that registrants with fiscal years that begin between December 16, 1999 and March 15, 2000, may report any resulting change in accounting principle no later than their second fiscal quarter of the fiscal year beginning after December 15, 1999. The adoption of SAB 101 did not have a material effect on our financial position or result of operations.

Item 7. Financial Statements.

The financial statements of the Company, including the notes thereto and report of the independent auditors thereon, are attached hereto as exhibits as page numbers F-1 through F-21.

Item 8. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

PART III

Item 9. Directors, Executive Officers, Promoters and Control Persons; Compliance with Section 16(a) of the Exchange Act of the Registrant.

The bylaws of Digital Power currently sets the number of directors constituting the entire board to be five, each to serve until the next annual meeting and until his successor shall be elected and qualified or until his earlier death, resignation, or removal. There are no family relationships between any of the directors and executive officers of Digital Power. The following table sets forth all the directors and executive officers of Digital Power and certain information with respect to those persons as of December 31, 2000.

Name	Age	Directors, Executive Officers and Background For the Past Five Years
Robert O. Smith	56	Chief Executive Officer and Director since 1989 and President since May 1996. From 1980 to 1989 variously served as Vice President/Group Controller of Power Conversion Group, General Manager of Compower Division, and President of Boschert subsidiary, of Computer Products, Inc., manufacturer of power conversion products and industrial automation systems. Received B.S. in Business Administration from Ohio University and completed course work in M.B.A. program at Kent State University.
Chris Schofield	44	Director of Digital Power since 1998. Managing Director of Digital Power Limited since January 1998. Director and General Manager of Gresham Power Group from 1995 to 1998. From 1988 to 1995, Director of United Kingdom Operations of the Oxford Instruments Group.
Thomas W. O'Neil, Jr.	71	Director since 1991. Certified Public Accountant and Partner since 1991 of Schultze, Wallace and O'Neil, CPAs. Retired as Partner, from 1955 to 1991, of KPMG Peat Marwick. Director of California Exposition and State Fair; Director of Regional Credit Association; Director of Alternative Technology Resources, Inc. Graduate of St. Mary's College and member of the St. Mary's College Board of Regents.

Name	Age	Directors, Executive Officers and Background For the Past Five Years
Scott C. McDonald	47	Director since May 1998. Chief Financial and Administrative Officer of Conxion Corporation since December 1999. Director of Castelle Incorporated since April 1999. Director of Octant Technologies, Inc. since April 1998. From November 1996 to May 1998, director of CIDCO Incorporated, a communications and information delivery company. From October 1993 to January 1997, Executive Vice President, Chief Operating and Financial Officer of CIDCO. From March 1993 to September 1993, President, Chief Operating and Financial Officer of PSI Integration, Inc. From February 1989 to February 1993, Chief Financial Officer and Vice President, Finance of Administration of Integrated System, Inc. Received B.S. in Accounting from The University of Akron and M.B.A. from Golden Gate University.
Robert J. Boschert	64	Business consultant for small high-growth technology companies. Director since 1990 of Hytek Microsystems, Inc. From June 1986 until June 1998, served as consultant to Union Technology. Founder of Boschert, Inc. Retired as a member of the board of directors in 1984. Received B.S. in Electrical Engineering from University of Missouri.
Philip G. Swany	51	Mr. Swany joined the Company as its Controller in 1981. In February 1992, he left the Company to serve as the Controller for Crystal Graphics, Inc., a 3-D graphics software development company. In September 1995, Mr. Swany returned to the Company where he was made Vice President-Finance. In May 1996, he was named Chief Financial Officer and Secretary of the Company. Mr. Swany received a B.S. degree in Business Administration - Accounting from Menlo College, and attended graduate courses in business administration at the University of Colorado.

Committees of the Board

The Board has an audit committee and a compensation committee. The audit committee currently consists of Messrs. McDonald, Boschert and O'Neil, and the compensation committee consists of Messrs. Boschert and McDonald. The Board does not have a nominating committee. The primary functions of the audit committee are to review the scope and results of audits by our independent auditors, our internal accounting controls, the non-audit services performed by the independent accountants, and the cost of accounting services. The compensation committee administers our 1996 stock option plan, our 1998 stock option plan, and our 2000 stock option plan and approves compensation, remuneration, and incentive arrangements for our officers and employees.

Compensation of Directors

Non-employee directors receive $10,000 per annum paid quarterly and options to purchase 10,000 shares of common stock.

Compliance with Section 16(a) of the Securities Exchange Act of 1934

Section 16(a) of the Securities Exchange Act of 1934 requires our directors, executive officers, and persons who own more than 10% of our outstanding common stock to file reports of ownership and changes in ownership with the SEC. Directors, executive officers, and shareholders of more the 10% of our common stock are required by SEC regulations to furnish us with copies of the Section 16(a) forms they file.

Based solely on a review of the copies of such forms furnished to us, or written representations that such filings were not required, we believe that, during the calendar year 2000, our directors and officers complied with the Section 16(a) filing requirements, except for Mr. Schofield who inadvertently was late in one filing reporting 8 transactions involving the issuance of options.

Item 10. Executive Compensation.

Executive officers are appointed by, and serve at the discretion of, the Board of Directors. Except for Robert O. Smith, our President and Chief Executive Officer, we have no employment agreements with any of our executive officers. The following table sets forth the compensation of our President and Chief Executive Officer during the past three years, our Secretary and Chief Financial Officer and one director. No other officer received annual compensation in excess of $100,000 during the 2000 fiscal year.

SUMMARY COMPENSATION TABLE

				Long Term Compensation			
		Annual Compensation		Awards		Payouts	
Name and Principal Position	Year	Salary	Other Annual Compensation ($)	Restricted Stock Award(s) ($)	Securities Underlying Options (#)	LTIP Payouts ($)	All Other Compensation
Robert O. Smith President and CEO	2000	$ 200,000	$2,458,197(2)	$ 0	100,000(3)	$ 0	$ 0
	1999	$ 134,038(1)	$ 0	$ 0	100,000(4)	$ 0	$ 0
	1998	$ 141,912(1)	$ 0	$ 0	100,000(5)	$ 0	$ 0
Philip G. Swany Secretary and CFO	2000	$ 63,253	$ 52,456(6)	$ 0	20,000(7)	$ 0	$ 0
Chris Schofield Director	2000	$ 105,927	$ 0	$ 0	25,000(8)	$ 0	$ 0

(1) Pursuant to Mr. Smith's employment contract, during 1999, Mr. Smith was entitled to receive $200,000 per annum and during 1998, was entitled to receive $175,000 per annum. Due to the financial condition of the Company, Mr. Smith only received $134,038 and $141,912 during 1999 and 1998, respectively.

(2) Represents the gain on the sale of 286,900 options exercised, with an exercise price ranging from $0.50 to $1.875 and sales price ranging from $6.00075 to $14.0166 per share.

(3) Represents options to acquire 100,000 shares of common stock at $1.5625 per share.

(4) Represents options to acquire 100,000 shares of common stock at $1.875 per share.

(5) Pursuant to his employment contract, in January 1998, Mr. Smith received options to acquire 100,000 shares of Common Stock at $6.69 per share. These options expire in January 2008. On November 5, 1998, these options were repriced to an exercise price of $2.31 per share.

(6) Represents the gain on the sale of 7,000 options exercised, with an exercise price of $1.80 and sales price ranging from $9.25 to $9.6875 per share.

(7) Represents options to acquire 20,000 shares of common stock at $2.375 per share.

(8) Represents options to acquire 25,000 shares of common stock at $1.5625 per share.

On March 1, 2000, Mr. Smith entered into an employment contract effective January 1, 2000. The term of the employment agreement is for one year subject to annual renewal. Under the terms of Mr. Smith's employment contract, Mr. Smith shall serve as President and Chief Executive Officer and his salary shall be $200,000 per annum and be entitled to bonuses as determined by the Board. In addition, he shall have the right to receive on the first business day of each January during the term of his contract options to acquire 100,000 shares of common stock at the lower of market value as of such date or the average closing price for the first six months of each year of his contract. Pursuant to Mr. Smith's employment contract, in the event there is a change in control of the Company, Mr. Smith shall be entitled to receive in one payment, the sum of six times his annual base salary. If Mr. Smith's employment agreement is not renewed or he is terminated without cause, Mr. Smith will be entitled to three times his annual base salary.

The following table sets forth the options granted to Mr. Smith during the past fiscal year.

OPTION GRANTS IN LAST FISCAL YEAR

	Individual Grants			
Name	Number of Securities Underlying Options Granted (#)	% of Total Options Granted to Employees in Fiscal Year	Exercise or Base Price ($/Sh)	Expiration Date
Robert O. Smith	100,000	27%	$1.5625	January 2010

The following table sets forth Mr. Smith's fiscal year end option values.

AGGREGATED OPTION EXERCISES IN LAST FISCAL YEAR
AND FISCAL YEAR-END OPTION VALUES

			Number of Unexercised Options at FY-End (#)	Value of Unexercised In-the-Money Options at FY-End ($)(1)
Name	Shares Acquired on Exercise (#)	Value Realized ($)	Exercisable/ Unexercisable	Exercisable/ Unexercisable
Robert O. Smith	286,900	2,458,197	200,000 Exercisable	$0 Exercisable

(1) Market price at December 29, 2000, for a share of common stock was $1,6875.

Stock Plans

Employee Stock Purchase Plan. We have adopted an Employee Stock Ownership Plan ("ESOP") in conformity with ERISA requirements. As of December 31, 2000, the ESOP owns, in the aggregate, 167,504 shares of our common stock. In June 1996, the ESOP entered into a $500,000 loan with San Jose National bank to finance the purchase of shares. We guaranteed the repayment of the loan, and our contributions to the ESOP were used to pay off the loan by the end of 1999. All our employees participate in the ESOP on the basis of level of compensation and length of service. Participation in the ESOP is subject to vesting over a six-year period. The shares of common stock owned by the ESOP are voted by the ESOP trustees. Mr. Smith, our President and Chief Executive Officer, is one of two trustees of the ESOP.

2000, 1998 and 1996 Stock Option Plans -

We have established the 2000, 1998 and 1996 Stock Option Plans (the "Plans"). The purposes of the Plans are to encourage stock ownership by our employees, officers, and directors to give them a greater personal interest in the success of the business and to provide an added incentive to continue to advance in their employment by or service to us. A total of 1,253,000 options are authorized to be issued under the Plans, of which 708,220 options have been issued. The Plans provide for the grant of either incentive or non-statutory stock options. The exercise price of any incentive stock option granted under the Plans may not be less than 100% of the fair market value of our common stock on the date of grant. The fair market value for which an optionee may be granted incentive stock options in any calendar year may not exceed $100,000. Shares subject to options under the Plans may be purchased for cash. Unless otherwise provided by the Board, an option granted under the Plans is exercisable for ten years. The Plans are administered by the compensation committee which has discretion to determine optionees, the number of shares to be covered by each option, the exercise schedule, and other terms of the options. The Plans may be amended, suspended, or terminated by the Board but no such action may impair rights under a previously granted option. Each incentive stock option is exercisable, during the lifetime of the optionee, only so long as the optionee remains employed by us. No option is transferrable by the optionee other than by will or the laws of descent and distribution.

Other Stock Options

As of December 31, 2000, we had outstanding options to acquire 30,500 shares of common stock at $1.80 per share. These options were granted to employees in May 1993 and are now fully vested.

401(k) Plan

We have adopted a tax-qualified employee savings and retirement plan (the "401(k) Plan"), which generally covers all of our full-time employees. Pursuant to the 401(k) Plan, employees may make voluntary contributions to the
401(k) Plan up to a maximum of six percent of eligible compensation. These deferred amounts are contributed to the 401(k) Plan. The 401(k) Plan permits, but does not require, additional matching and our contributions on behalf of
401(k) Plan participants. We match contributions at the rate of $.25 for each $1.00 contributed. We can also make discretionary contributions. The 401(k) Plan is intended to qualify under Sections 401(k) and 401(a) of the Internal Revenue Code of 1986, as amended. Contributions to such a qualified plan are deductible to us when made and neither the contributions nor the income earned on those contributions is taxable to the 401(k) Plan participants until withdrawn. All
401(k) Plan contributions are credited to separate accounts maintained in trust.

Item 11. Security Ownership of Certain Beneficial Owners and Management.

The following table sets forth, as of March 15, 2001, certain information with respect to the beneficial ownership of our shares of common stock by all shareholders known by us to be the beneficial owners of more than five percent of the outstanding shares of such common stock, all our directors and named executive officers individually, and all directors and all executive officers of Digital Power as a group. As of March 15, 2001, there were 3,260,680 shares of common stock outstanding.

Name	No. of Shares Common Stock(1)	Percent
Digital Power - ESOP 41920 Christy Street Fremont, CA 94538	167,504	5.14%
Thomas W. O'Neil, Jr., Director	55,600(2)	1.68%
Robert O. Smith, Director and Chief Executive Officer	379,004(3)	10.95%
Chris Schofield, Managing Director, Digital Power Limited	47,000(4)	1.42%
Philip G. Swany, Chief Financial Officer	42,250(5)	1.28%
Scott C. McDonald, Director	20,000(6)	*
Robert J. Boschert, Director	20,000(6)	*
All directors and executive officers as a group (6 persons)	563,854(7)	15.51%

* Less than one percent.

(1) Except as indicated in the footnotes to this table, the persons named in the table have sole voting and investment power with respect to all shares of common stock shown as beneficially owned by them, subject to community property laws where applicable.

(2) Includes 40,000 shares subject to options exercisable within 60 days.

(3) Includes 211,500 shares subject to options exercisable within 60 days. Also includes 167,504 owned by the Digital Power ESOP of which Mr. Smith is a trustee.

(4) Includes 40,000 shares subject to options exercisable within 60 days.

(5) Includes 42,250 shares subject to options exercisable within 60 days.

(6) Includes 20,000 shares subject to options and exercisable within 60 days.

(7) Includes 373,750 shares subject to options and warrants and exercisable within 60 days. Also includes 167,504 shares owned by the Digital Power ESOP of which Mr. Smith is a trustee and may be deemed a beneficial owner.

Item 12. Certain Relationships and Related Transactions.

None.

Item 13. Exhibits and Reports on Form 8-K.

(a) Exhibits

3.1 Amended and Restated Articles of Incorporation of Digital Power Corporation(1)
3.2 Amendment to Articles of Incorporation(1)
3.3 Bylaws of Digital Power Corporation(1)
4.1 Specimen Common Stock Certificate(2)
4.2 Specimen Warrant(1)
4.3 Representative's Warrant(1)
10.1 Revolving Credit Facility with San Jose National Bank(1)
10.2 KDK Contract(1)
10.3 Agreement with Fortron/Source Corp.(1)
10.4 Employment Agreement With Robert O. Smith(2)
10.5 1996 Stock Option Plan(1)
10.6 Gresham Power Asset Purchase Agreement(3)
10.7 1998 Stock Option Plan (5)
10.8 Technology Transfer Agreement with KDK Electronics(4)
10.9 Loan Commitment and Letter Agreement(5)
10.10 Promissory Note(5)
10.11 Employment Agreement with Robert O. Smith(6)
21.1 The Company's subsidiaries consist of Poder Digital S.A. de C.V., a corporation formed under the laws of Mexico, and Digital Power Limited, a corporation formed under the laws of the United Kingdom.
23.1 Consent of Hein + Associates LLP

(1) Previously filed with the Commission on October 16, 1996, to the Company's Registration Statement on Form SB-2.
(2) Previously filed with the Commission on December 3, 1996, to the Company's Pre-Effective Amendment No. 1 to Registration Statement on Form SB-2.
(3) Previously filed with the Commission on February 2, 1998, to the Company's Form 8-K.
(4) Previously filed with the Commission with its Form 10-QSB for the quarter ended September 30, 1998.
(5) Previously filed with the Commission with its Form 10-KSB for the year ended December 31, 1998.
(6) Previously filed with the Commission with its Form 10-KSB for the year ended December 31, 1999.

(b) Reports on Form 8-K

None.

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: April 10, 2001 *DIGITAL POWER CORPORATION,*
a California Corporation

/s/ ROBERT O. SMITH

Robert O. Smith,
Chief Executive Officer

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signatures	Date
/s/ ROBERT O. SMITH Robert O. Smith, Chief Executive Officer (Principal Executive Officer)	April 10, 2001
/s/ PHILIP G. SWANY Philip G. Swany, Chief Financial Officer (Principal Accounting and Financial Officer)	April 10, 2001
/s/ ROBERT J. BOSCHERT Robert J. Boschert, Director	April 10, 2001
/s/ SCOTT C. MCDONALD Scott C. McDonald, Director	April 10, 2001

Thomas W. O'Neil, Jr., Director

Signatures	Date
/s/ CHRIS SCHOFIELD Chris Schofield, Director	April 10, 2001

INDEPENDENT AUDITOR'S REPORT

INDEPENDENT AUDITOR'S REPORT

To the Stockholders and Board of Directors Digital Power Corporation and Subsidiaries Fremont, California

We have audited the accompanying consolidated balance sheet of Digital Power Corporation and Subsidiaries as of December 31, 2000, and the related consolidated statements of income, stockholders' equity, and cash flows for the years ended December 31, 2000 and 1999. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Digital Power Corporation and subsidiaries as of December 31, 2000, and the results of their operations and their cash flows for the years ended December 31, 2000 and 1999, in conformity with generally accepted accounting principles.

/s/HEIN + ASSOCIATES LLP

HEIN + ASSOCIATES LLP
Certified Public Accountants

Orange, California
March 9, 2001

DIGITAL POWER CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

	DECEMBER 31, 2000
ASSETS	
CURRENT ASSETS:	
Cash and cash equivalents	$ 806,407
Accounts receivable - trade, net of allowance for doubtful accounts of $231,419	3,256,082
Income tax refund receivable	179,200
Other receivables	90,454
Inventories, net	5,143,624
Prepaid expenses and deposits	213,699
Deferred income taxes	334,037
Total current assets	10,023,503
PROPERTY AND EQUIPMENT, net	1,094,733
EXCESS OF PURCHASE PRICE OVER NET ASSETS ACQUIRED, net of accumulated amortization of $433,926	1,018,263
OTHER ASSETS	28,551
TOTAL ASSETS	$ 12,165,050
LIABILITIES AND STOCKHOLDERS' EQUITY	
CURRENT LIABILITIES:	
Notes payable	$ 400,000
Current portion of capital lease obligations	42,954
Accounts payable	1,949,182
Accrued liabilities	1,169,702
Total current liabilities	3,561,838
CAPITAL LEASE OBLIGATIONS, less current portion	61,938
Total liabilities	3,623,776
COMMITMENTS AND CONTINGENCIES (Notes 7 and 12)	
STOCKHOLDERS' EQUITY:	
Preferred stock issuable in series, no par value, 2,000,000 shares authorized, no shares issued and outstanding.	-
Common stock, no par value, 10,000,000 shares authorized, 3,260,680 shares issued and outstanding	9,786,251
Additional paid-in capital	733,256
Accumulated deficit	(1,730,934)
Accumulated other comprehensive loss	(247,299)
Total stockholders' equity	8,541,274
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 12,165,050

DIGITAL POWER CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

	FOR THE YEARS ENDED DECEMBER 31, 2000	1999
REVENUES	$ 17,882,730	$ 15,354,018
COST OF GOODS SOLD	13,223,441	11,277,170
Gross margin	4,659,289	4,076,848
OPERATING EXPENSES:		
Research and development	1,166,015	952,690
Marketing and selling	1,348,545	1,159,323
General and administrative	1,895,280	1,644,170
Total operating expenses	4,409,840	3,756,183
INCOME FROM OPERATIONS	249,449	320,665
OTHER INCOME (EXPENSE):		
Interest income	29,920	30,935
Interest expense	(90,992)	(178,343)
Gain (loss) on disposal of assets	10,790	(16,830)
Other income (expense)	(50,282)	(164,238)
INCOME BEFORE INCOME TAXES	199,167	156,427
INCOME TAX PROVISION	104,000	123,000
NET INCOME	$ 95,167	$ 33,427
NET INCOME PER COMMON SHARE:		
Basic net income per share	$ 0.03	$ 0.01
Diluted net income per share	$ 0.03	$ 0.01

See accompanying notes to these consolidated financial statements.

DIGITAL POWER CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY FOR THE YEARS ENDED DECEMBER 31, 2000 AND 1999

	COMMON STOCK SHARES	COMMON STOCK AMOUNT	ADDITIONAL PAID-IN CAPITAL	ESOP SHARES	NOTE RECEIVABLE STOCK-HOLDER	ACCUMU-LATED DEFICIT	ACCUMULATED OTHER COMPRE-HENSIVE INCOME (LOSS)	TOTAL STOCK HOLDERS' EQUITY	COMPRE-HENSIVE (LOSS)
BALANCES, January 1, 1999	2,771,435	$ 9,012,679	$ 514,304	$(184,919)	$ --	$(1,859,528)	$ 36,234	$ 7,518,770	
Contribution to ESOP	--	--	--	184,919	--	--	--	184,919	
Note receivable for common stock	--	--	52,200	--	(52,200)	--	--	--	
Comprehensive loss:									
Net income	--	--	--	--	--	33,427	--	33,427	$ 33,427
Foreign currency ranslation adjustment	--	--	--	--	--	--	(84,909)	(84,909)	(84,909)
Total comprehensive loss	--	--	--	--	--	--	--	--	$(51,482)
BALANCES, December 31, 1999	2,771,435	9,012,679	566,504	--	(52,200)	(1,826,101)	(48,675)	7,652,207	
Exercise of stock options	484,245	754,197	(52,200)	--	52,200	--	--	754,197	
Income tax benefit related to exercise of stock options	--	--	101,397	--	--	--	--	101,397	
Stock issued for services	5,000	19,375	--	--	--	--	--	19,375	
Compensation cost recognized upon issuance of warrants for services	--	--	117,555	--	--	--	--	117,555	
Comprehensive loss:									
Net income	--	--	--	--	--	95,167	--	95,167	$ 95,167
Foreign currency translation adjustment	--	--	--	--	--	--	(198,624)	(198,624)	(198,624)
Total comprehensive loss	--	--	--	--	--	--	--	--	$(103,457)
BALANCES, December 31, 2000	3,260,680	$ 9,786,251	$ 733,256	$ --	$ --	$(1,730,934)	$(247,299)	$ 8,541,274	

See accompanying notes to these consolidated financial statements.

DIGITAL POWER CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	FOR THE YEARS ENDED DECEMBER 31,	
	2000	1999
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 95,167	$ 33,427
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	475,987	500,691
(Gain) loss on disposal of assets	(10,790)	16,830
Deferred income taxes	16,755	8,813
Warranty expense	55,000	(110,000)
Inventory reserve	--	30,000
Contribution to ESOP	--	184,919
Bad debt expense	23,504	35,547
Compensation cost recognized upon issuance of warrants	117,555	--
Income tax benefit related to exercise of stock options	101,397	--
Stock issued for services	19,375	--
Changes in operating assets and liabilities:		
Accounts receivable	(466,506)	711,411
Income tax refund receivable	(108,212)	321,658
Other receivables	9,421	3,167
Inventories	(612,363)	303,259
Prepaid expenses	(152,372)	(6,062)
Other assets	(14,493)	26,733
Accounts payable	753,013	(50,685)
Accrued liabilities	(98,939)	(271,457)
Other long-term liabilities	(25,000)	(10,043)
Net cash provided by operating activities	178,499	1,728,208
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(176,068)	(168,042)
Proceeds from sale of assets	26,121	6,146
Net cash used in investing activities	(149,947)	(161,896)

DIGITAL POWER CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Continued)

	FOR THE YEARS ENDED DECEMBER 31, 2000	1999
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from exercise of stock options and warrants	$ 754,197	$ --
Principal payments on long-term debt	(540,000)	(184,919)
Principal payments on capital lease obligations	(62,426)	(72,537)
Principal payments on notes payable	--	(1,266,846)
Net cash provided by (used in) financing activities	151,771	(1,524,302)
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(198,624)	(84,909)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(18,301)	(42,899)
CASH AND CASH EQUIVALENTS, beginning of period	824,708	867,607
CASH AND CASH EQUIVALENTS, end of period	$ 806,407	$ 824,708
SUPPLEMENTAL CASH FLOW INFORMATION:		
Cash payments for:		
Interest	$ 131,650	$ 277,935
Income taxes	$ 180,000	$ 117,494
NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Acquisition of equipment through capital leases	$ 42,846	$ 19,720

See accompanying notes to these consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1 ORGANIZATION AND NATURE OF OPERATIONS:

Digital Power Corporation ("DPC"), a California corporation, and its wholly owned subsidiaries, Poder Digital, S.A. de C.V. ("PD"), located in Guadalajara, Mexico, and Digital Power Limited ("DPL"), located in the United Kingdom, are engaged in the design, manufacture and sale of switching power supplies. DPC, PD, and DPL are collectively referred to as the "Company".

2. SIGNIFICANT ACCOUNTING POLICIES:

Principles of Consolidation - The consolidated financial statements include the accounts of DPC and its wholly owned subsidiaries, PD and DPL. All significant intercompany accounts and transactions have been eliminated in consolidation.

Statements of Cash Flows - For purposes of the statements of cash flows, the Company considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents.

Inventories - Inventories are stated at the lower of cost (first-in, first-out) or market.

Property and Equipment - Property and equipment are stated at cost. Depreciation of equipment and furniture is calculated using the straight-line method over the estimated useful lives (ranging from 5 to 10 years) of the respective assets. Leasehold improvements are amortized over the shorter of their estimated useful life or the term of the lease. The cost of normal maintenance and repairs is charged to operations as incurred. Material expenditures that increase the life of an asset are capitalized and depreciated over the estimated remaining useful life of the asset. The cost of fixed assets sold, or otherwise disposed of, and the related accumulated depreciation or amortization are removed from the accounts, and any resulting gains or losses are reflected in current operations.

Excess of Purchase Price Over Net Assets Acquired - Excess of purchase price over net assets acquired ("Goodwill") represents the purchase price in excess of the fair value of the net assets of the acquired business and is being amortized using the straight-line method over its estimated useful life of ten years.

Income Taxes - The Company accounts for income taxes under the liability method which requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on the differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Revenue Recognition - Sales revenue is recognized when the products are shipped to customers, including distributors. Customers receive a one or two-year product warranty and certain sales to distributors are subject to a limited right of return. At the same time sales revenue is recognized, the Company provides a reserve for estimated warranty costs and a reserve for estimated product returns.

Research and Development Costs - Research and development costs are charged to operations in the period incurred.

Foreign Currency Translation - Gains and losses from the effects of exchange rate fluctuations on transactions denominated in foreign currencies are included in the results of operations. Assets and liabilities of the Company's foreign subsidiaries are translated into U.S. dollars at year-end exchange rates. Income and expense items are translated at average exchange rates prevailing during the year. The resulting translation adjustment is recorded as a component of accumulated other comprehensive income (loss), a component of stockholders equity.

Earnings Per Share - Basic earnings per share excludes dilution and is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity. The dilutive share base for the year ended December 31, 2000 and 1999 excludes incremental shares of 24,346 and 391,181, respectively, which relate to employee stock options and 82,742 and 81,390 which relate to warrants to consultants.

Use of Estimates - The preparation of the Company's consolidated financial statements in conformity with generally accepted accounting principles requires the Company's management to make estimates and assumptions that affect the amounts reported in these consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

The Company's consolidated financial statements are based upon a number of significant estimates, including the allowance for doubtful accounts, technological obsolescence of inventories, the estimated useful lives selected for property and equipment and goodwill, realizability of deferred tax assets, allowance for sales returns, and warranty reserve. Due to the uncertainties inherent in the estimation process, it is at least reasonably possible that these estimates will be further revised in the near term and such revisions could be material.

Impairment of Long-Lived Assets - In the event that facts and circumstances indicate that the cost of long lived assets may be impaired, an evaluation of recoverability would be performed. If an evaluation is required, the estimated future undiscounted cash flows associated with the asset would be compared to the asset's carrying amount to determine if a write-down to market value or discounted cash flow value is required.

Stock Based Compensation - The Company has elected to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB25) and related interpretations in accounting for its employee stock options. In accordance with FASB Statement No. 123 "Accounting for Stock-Based Compensation" (FASB123), the Company will disclose the impact of adopting the fair value accounting of employee stock options. Transactions in equity instruments with non-employees for goods or services have been accounted for using the fair value method as prescribed by FASB123.

Concentrations of Credit Risk - Credit risk represents the accounting loss that would be recognized at the reporting date if counterparties failed completely to perform as contracted. Concentrations of credit risk (whether on or off balance sheet) that arise from financial instruments exist for groups of customers or counterparties when they have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions described below. In accordance with FASB Statement No. 105, "Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentrations of Credit Risk," financial instruments that subject the Company to credit risk consist of cash balances maintained in excess of federal depository insurance limits and accounts and notes receivable, which have no collateral or security. See Note 13 for major customers.

Fair Value of Financial Instruments - The estimated fair values for financial instruments under FASB Statement No. 107, Disclosures about Fair Value of Financial Instruments, are determined at discrete points in time based on relevant market information. These estimates involve uncertainties and cannot be determined with precision. The estimated fair value of cash, cash equivalents, account receivable and accounts payable approximates their carry value due to their short-term nature. The estimated fair value of long-term debt approximates its carrying value because it carries interest rates which approximates market rates.

Comprehensive Income - The Company has adopted the Financial Accounting Standards Board Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income" (FASB130). FASB130 defines comprehensive income as all changes in stockholders' equity exclusive of transactions with owners, such as capital investments. Comprehensive income includes net income or loss and changes in certain assets and liabilities that are reported directly in equity, such as, translation adjustments on investments in foreign subsidiaries.

Impact of Recently Issued Standards - In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133 (FASB133), "Accounting for Derivative Instruments and Hedging Activities." The FASB has subsequently issued Statement No. 137 and Statement No. 138 which are amendments to FASB133. FASB133, as amended, requires that an entity recognize all derivatives as assets or liabilities in the statement of financial position and measure those instruments at fair value. FASB133, as amended, is effective for fiscal years beginning after June 15, 2000. FASB133, as amended, cannot be applied retroactively and must be applied to (a) derivative instruments and (b) certain derivative instruments embedded in hybrid contracts. The Company adopted SFAS133, as amended, beginning January 1, 2001. Management does not believe the adoption of FASB133 will have a material impact on the Company's financial position or results of operation.

In December 1999, the Securities and Exchange Commission (SEC) released Staff Accounting Bulletin 101 (SAB 101) "Revenue Recognition in Financial Statements." SAB 101 establishes guidelines in applying generally accepted accounting principles to the recognition of revenue in financial statements based on the following four criteria:
persuasive evidence that an arrangement exists, delivery has occurred or services have been rendered, the seller's price to the buyer is fixed or determinable, and collectibility is reasonably assured. SAB 101, as amended by SAB 101A and SAB 101B, is effective no later than the fourth fiscal quarter of the fiscal years beginning after December 15, 1999, except that registrants with fiscal years that begin between December 16, 1999 and March 15, 2000, may report any resulting change in accounting principle no later than their second fiscal quarter of the fiscal year beginning after December 15, 1999. The adoption of SAB 101 did not have a material effect on our financial position or result of operations.

3. INVENTORIES:

Inventories consists of the following as of December 31, 2000:

Raw materials	$ 4,329,160
Work-in-process	1,011,966
Finished goods	459,030
	5,800,156
Allowance for obsolescence	(656,532)
	$ 5,143,624

4. PROPERTY AND EQUIPMENT:

Property and equipment consist of the following as of December 31, 2000:

Machinery and equipment	$ 1,441,203
Office equipment and furniture	873,429
Leasehold improvements	539,777
Transportation equipment	103,839
	2,958,248
Accumulated depreciation and amortization	(1,863,515)
	$ 1,094,733

5. ACCRUED LIABILITIES:

Accrued liabilities consist of the following as of December 31, 2000:

Accrued payroll and benefits	$ 147,115
Accrued commissions and royalties	126,786
Accrued warranty and product return expense	324,602
Income taxes payable	308,627
Accrued legal and professional fees	51,739
Other	210,833
	$ 1,169,702

6. NOTES PAYABLE :

DPC has a $3,000,000 line of credit pursuant to a promissory note agreement. The line of credit agreement provides for borrowings up to 80% of eligible accounts receivable, plus 20% of inventory or $500,000, whichever is less, not to exceed a total of $3,000,000. Borrowing under this line of credit bears interest based upon an index equal to the lender's prime rate (totaling 9.50% at December 31, 2000), interest only, payable monthly with outstanding principal due on demand. If no demand is made, the outstanding principal and unpaid accrued interest is due September 15, 2001. At December 31, 2000, the outstanding principal balance was $400,000. Under the terms of the agreement, the Company is required to maintain certain ratios and be in compliance with other covenants. At December 31, 2000, the Company was in compliance with all covenants.

DPL has a $500,000 line of credit pursuant to a loan agreement. Borrowing under this line of credit bears interest at 2% per annum over the Bank's Base rate (totaling 8.5% at December 31, 2000), interest only, payable monthly with outstanding principal due on demand. If no demand is made, the outstanding principal and accrued interest is due March 31, 2001. In the event of the loan being used, the loan would be collateralized by substantially all of the DPL's assets. At December 31, 2000, no principal or accrued interest was outstanding. Under the terms of the agreement, if borrowings exist under this line of credit, the Company is required to maintain certain ratios and be in compliance with other covenants.

7. CAPITAL LEASE OBLIGATIONS:

The Company leases certain equipment and vehicles under agreements classified as capital leases. The net book value of assets under capital leases is $106,329. Depreciation expense of $52,147 was recognized for the year ended December 31, 2000.

The future minimum lease payments as of December 31, 2000, are as follows:

YEARS ENDING DECEMBER 31,	AMOUNT
2001	$ 45,870
2002	39,348
2003	26,665
Total future minimum lease payments	111,883
Less amount representing interest	(6,991)
Present value of net minimum lease payments	104,892
Less Current portion	(42,954)
	$ 61,938

8. PREFERRED STOCK:

The preferred stock has one series authorized, 500,000 shares of Series A cumulative redeemable convertible preferred stock ("Series A"), and an additional 1,500,000 shares of preferred stock has been authorized, but the rights, preferences, privileges and restrictions on these shares has not been determined. DPC's Board of Directors is authorized to create new series of preferred stock and fix the number of shares as well as the rights, preferences, privileges and restrictions granted to or imposed upon any series of preferred stock.

9. NOTE RECEIVABLE - STOCKHOLDER:

At December 31, 1999, the Company had a note receivable in the amount of $52,200 due from a former employee received in consideration for the exercise of stock options. The note had an interest rate at 5% and was paid in full in February 2000.

10. STOCK OPTIONS AND WARRANTS:

Stock Options - In May 1996, the Company adopted the 1996 Stock Option Plan covering 513,000 shares. Under the plan, the Company can issue either incentive or non-statutory stock options. The price of the options granted pursuant to the plan will not be less than 100% of the fair market value of the shares on the date of grant. The compensation committee of the board of directors will decide the vesting period of the options, if any, and no option will be exercisable after ten years from the date granted.

During the year ended December 31, 2000 and 1999, the Company issued in each year non-qualified options for the purchase of 100,000 shares of the Company's common stock to the president of the Company, in accordance with his employment agreement. The exercise prices of $1.5625 and $ 1.8750 per hare were equal to the fair market value on the date of grant. Such options vested immediately and expire beginning in 2009.

During the period ended December 31, 2000, the Company granted options for the purchase of 117,500 shares of the Company's common stock under the 1996 Stock Option Plan to certain employees. The exercise price of the options of 2.3750 per share which was equal to the fair market value on the date of grant. The options vest over 5 years at 25% per year starting in the second year.

During each of the years ended December 31, 2000, and 1999, the Company granted non-qualified options under the 1998 plan for the purchase of 30,000 shares the Company's common stock to outside directors. The exercise prices range from $1.93 to $2.3750 per share, which was equal to the fair value on the date of grant. The options vest after one year and expire beginning 2009.

During the year ended December 31, 1999, the Company granted options for the purchase of 70,000 shares of the Company's common stock under the 1996 Stock Option Plan to certain employees. The exercise prices range from $1.6875 to $2.00 per share, which was equal to the fair market value on the date of grant. The options vest over 5 years at 25% per year starting in the second year.

In February 1998, the Company adopted the 1998 Stock Option Plan covering 240,000 shares of common stock. Under the plan, the Company can issue either incentive or non-qualified stock options. The exercise price of the options granted pursuant to the plan will not be less than 100% of the fair market value of the shares on the grant date. The compensation committee of the Board of Directors will determine the vesting period of the options, if any, and no options will be exercisable after ten years from the date of grant.

During the year ended December 31, 1999, the Company granted options for the purchase of 11,900 shares of the Company's common stock under the 1998 Stock Option Plan to certain employees. The exercise prices of the options range from $1.5625 to $1.8750 per share, which was equal to the fair market value on the date of grant. The options vest over 5 years at 25% per year starting in the second year.

During the period ended December 31, 2000, the Company granted options for the purchase of 57,500 shares of the Company's common stock under the 1998 Stock Option Plan to certain employees. The exercise price of the options of 2.3750 per share which was equal to the fair market value on the date of grant. The options vest over 5 years at 25% per year starting in the second year.

In April 2000, the Company adopted the 2000 Stock Option Plan covering 500,000 shares of common stock. Under the plan, the Company can issue either incentive or non-qualified stock options. The exercise price of the options granted pursuant to the plan will not be less than 100% of the fair market value of the shares on the grant date. The compensation committee of the Board of Directors will determine the vesting period of the options, if any, and no options will be exercisable after ten years from the date of grant.

During the period ended December 31, 2000, the Company granted options for the purchase of 53,000 shares of the Company's common stock under the 2000 Stock Option Plan to certain employees. The exercise price of the options range from 2.3750 to 3.8750 per share which was equal to the fair market value on the date of grant. The options vest over 5 years at 25% per year starting in the second year.

The following table sets forth activity for all options:

	NUMBER OF SHARES	AVERAGE EXERCISE PRICE PER SHARE
OUTSTANDING, January 1, 1999	1,065,930	$ 2.19
Granted	211,900	1.90
Forfeited	(194,200)	2.42
OUTSTANDING, December 31, 1999	1,083,630	2.09
Granted	366,000	2.16
Forfeited	(26,665)	3.31
Exercised	(484,245)	1.56
OUTSTANDING, December 31, 2000	938,720	$ 2.39

At December 31, 2000, options to purchase 40,000 shares, with a weighted average exercise price of $6.06, were exercisable at prices ranging from $6.00 to $6.25 per share.

At December 31, 2000 options to purchase 504,166 shares were exercisable with exercise prices ranging from $1.56 to $2.31 per share, a weighted average exercise price of $2.17 and a weighted average remaining contractual life of 7.85 years. The remaining 394,554 unvested options are exercisable as follows:

YEAR ENDING DECEMBER 31,	NUMBER OF SHARES	WEIGHTED AVERAGE EXERCISE PRICE
2001	130,368	$ 2.29
2002	130,366	2.39
2003	76,975	2.27
2004	56,845	2.39
	394,554	$ 2.30

If not previously exercised the outstanding options will expire as follows:

YEAR ENDING DECEMBER 31,	NUMBER OF SHARES	WEIGHTED AVERAGE EXERCISE PRICE
2003	30,500	$ 1.80
2006	181,250	2.08
2007	202,675	2.31
2008	66,900	2.34
2009	457,395	2.36
	938,720	$ 2.39

Warrants - In December 1996, in connection with the initial public offering, the Company granted warrants for the purchase of 150,000 shares of the Company's common stock The exercise prices of the warrants range from $4.80 to $5.00 per share. The warrants vested immediately and expire in 2001.

During March 1997, the Company granted warrants for the purchase of 15,000 shares of the Company's common stock in connection with investor related services provided to the Company. The warrants have an exercise price of $6.75 per share, vested immediately and expire in 2002.

In January 1998, the Company issued warrants to purchase 30,000 shares of the Company's common stock in connection with investor related services provided to the Company. The warrants have an exercise price of $7.00 per share, vested immediately and expire in 2001.

In October 2000, the Company issued warrants to purchase 60,000 shares of common stock at $3.88 per share to an investor relations firm for services provided. Compensation expense of $117,555 was recognized upon issuance of the warrants. The warrants are immediately exercisable and expire in October 2001.

The following sets forth the activity for all warrants:

	NUMBER OF SHARES	AVERAGE EXERCISE PRICE PER SHARE
OUTSTANDING, January 1, 1999	838,090	$ 5.09
Expired	(643,090)	5.00
OUTSTANDING, December 31, 1999	195,000	5.38
Grants	60,000	3.88
Expired	-	-
OUTSTANDING, December 31, 2000	255,000	$ 5.03

As stated in Note 2, the Company has not adopted the fair value accounting prescribed by FASB123 for employees. Had compensation cost for stock options or warrants issued to employees been determined based on the fair value at grant date for awards in 2000 and 1999, consistent with the provisions of FASB123, the Company's net income (loss) and net income (loss) per share would have been reduced to the proforma amounts indicated below:

	2000	1999
Net loss	$ (158,079)	$ (320,445)
Net loss per common share:		
Basic and diluted	$ (0.05)	$ (0.12)

The fair value of each option or warrant was estimated on the date of grant using the Black-Scholes option pricing model using the following assumptions: average risk-free interest rates ranging from 4.6% to 5.6%, expected life of five years, dividend yield of 0%; and expected volatility ranging from 55.0% to 56.8%. The weighted-average fair value of the options on the grant date for the years ended December 31, 2000 and 1999 was $0.94 and $2.09 per share, respectively.

11. NET INCOME PER COMMON SHARE:

The following represents the calculation of net income per common share:

	2000	1999
BASIC		
Net income applicable to common shareholders	$ 95,167	$ 33,427
Weighted average number of common shares	2,939,034	2,771,435
Basic earnings per share	$ 0.03	$ 0.01
DILUTED		
Net income applicable to common shareholders	$ 95,167	$ 33,427
Weighted average number of common shares	2,939,034	2,771,435
Common stock equivalent shares representing shares issuable upon exercise of stock options	336,349	61,447
Weighted average number of shares used in calculation of diluted income per share	3,275,383	2,832,882
Diluted earnings per share	$ 0.03	$ 0.01

12. COMMITMENTS:

LEASES - The Company leases its office space in California, a manufacturing facility in Guadalajara, Mexico, and the facility and certain equipment in the UK under operating leases. The total future minimum lease payments, as of December 31, 2000, are as follows:

YEARS ENDING DECEMBER 31,

2001	$ 351,599
2002	361,488
2003	291,088
2004	122,713
2005	108,013
Thereafter	927,255
	$ 2,162,156

Lease payments on the manufacturing facility in Mexico are to be made in Mexican Pesos. Lease payments on the facility and equipment in the UK are to be made in GB pound-sterling. The above schedule was prepared using the conversion rates in effect at December 31, 2000. Changes in the conversion rate will have an impact on the Company's required minimum payments and its operating results.

Rent expense was $172,560 and $253,530 for the years ended December 31, 2000 and 1999, respectively.

ROYALTY AGREEMENT - The Company had a royalty agreement with a third party on various products, and any derivatives from the base design of these products.

In April 1998, the third party filed a lawsuit against the Company related to this agreement. This lawsuit was settled in September 1998. In exchange for the release of all future obligations under the royalty agreement, the Company agreed to pay $150,000 and issue 35,000 shares of common stock valued at $60,156. The shares were issued upon the close of the agreement. The $150,000 was due in installments through June 2000. As of December 31, 1999, the Company had paid $118,000 in installments with the remaining $32,000 being included in accrued liabilities. The remaining balance due was paid in full during the year ended December 31, 2000.

EMPLOYMENT AGREEMENT - The Company has an employment contract with its President/CEO that terminates on December 31, 2000. The contract provides for an automatic one-year renewal unless terminated by either the Company or the employee. Under the terms of the employment contract, he shall serve as president and chief executive officer of the Company for a salary of $200,000 per annum. In addition, pursuant to the contract, he shall have the right to receive on the first business day of each January during the term of his contract options to acquire 100,000 shares of Common Stock at the lower of market value per share as of such date or the average per share bid price for the first six months beginning from the date of grant of this option. Also, pursuant to the employment contract, in the event there is a change in control of the Company, the employee shall be paid, in one payment, the sum of six times the annual base salary for the year preceding the announcement of the change in control.

Finally, pursuant to the employment contract, in the event of termination without cause, the employee shall receive in one lump sum an amount equal to three times the employees base salary for the year preceding the termination.

13. MAJOR CUSTOMERS:

The Company frequently sells large quantities of inventory to its customers. For the year ended December 31, 2000, three customers accounted for 29% of the Company's net sales. For the year ended December 31, 1999, two customers accounted for 11% of the Company's net sales.

For the year ended December 31, 2000 and 1999, DPL contributed 29% and 42%, respectively, of the Company's revenues. No one customer of DPL contributed greater than 10% of the Company's consolidated revenues for the years ended December 31, 2000 and 1999.

14. EMPLOYEE BENEFIT PLANS:

401(K) PROFIT SHARING PLAN - The Company has a 401(k) profit sharing plan (the "Plan") covering substantially all employees of DPC. Eligible employees may make voluntary contributions to the Plan, which are matched by the Company at a rate of $.25 for each $1.00 contributed, up to a maximum of six percent of eligible compensation. The Company can also make discretionary contributions. The Company made matching contributions to the Plan of $12,665 and $11,400 for years ended December 31, 2000 and 1999, respectively.

The Company's subsidiary DPL, has a group personal pension plan covering substantially all of its employees. Eligible employees may make voluntary contributions to the plan. The Company will contribute 7% of the employees basic annual salary to the plan. Contributions are charged to operations as incurred. The Company made contributions totaling $66,908 and $71,400 to the plan for the years ended December 31, 2000 and 1999, respectively.

EMPLOYEE STOCK OWNERSHIP PLAN - The Company also has an employee stock ownership plan (the "ESOP") covering substantially all employees of DPC. The Company can make discretionary contributions of cash or company stock (as defined in the ESOP plan document) up to deductible limits prescribed by the Internal Revenue Code.

Effective June 13, 1996, the ESOP obtained a $500,000 loan guaranteed by the Company for the purpose of acquiring common stock of the Company from existing stockholders. The loan bore interest at 8.5% per annum and required monthly payments of principal and interest of $8,852 through June 2000. Immediately upon the funding of the loan, the ESOP purchased approximately 167,504 shares of the Company's common stock from existing shareholders. The Company was required to contribute amounts to the plan to sufficiently cover the debt payments. Contributions to the plan in 1999 were $184,919.

15. INCOME TAXES:

Income tax expense (benefit) is comprised of the following:

FOR THE YEARS ENDED
DECEMBER 31,

	2000	1999
Current		
Federal	$ 60,000	$ (28,000)
State	21,000	1,000
Foreign	23,000	143,000
	104,000	116,000
Deferred		
Federal	-	2,000
State	-	5,000
Foreign	-	-
	-	7,000
	$ 104,000	$ 123,000

The components of the net deferred tax asset and liability recognized as of December 31, 2000 are as follows:

Current deferred tax assets (liabilities):	
Accounts receivable, principally due to allowance for doubtful accounts	$ 92,723
Compensated absences, principally due to accrual for financial reporting purposes	30,317
Accrued commissions	2,267
Inventory reserve	204,714
Warranty reserve	100,350
Stock rotation liability	20,070
UNICAP	16,104
Other	(16,758)
	449,787
Valuation allowance	(115,750)
Net current deferred tax asset	$ 334,037
Long-term deferred tax assets (liabilities):	
Net operating loss and credit carryforwards	36,300
Goodwill	127,290
Depreciation	24,142
	187,732
Valuation allowance	(187,732)
Net long-term deferred tax liability	$ -

Total income tax expense differed from the amounts computed by applying the U.S. federal statutory tax rates to pre-tax income as follows:

	FOR THE YEARS ENDED DECEMBER 31,	
	2000	1999
Total expense (STET) computed by applying the U.S. statutory rate	34.0%	34.0%
Permanent differences	5.1	2.3
State income taxes	10.9	3.8
Tax effect resulting from foreign activities	(101.0)	41.5
Change in valuation allowance	105.2	-
Other	0.3	-
	54.5%	81.6%

The Company will continue to assess the realizability of the deferred tax assets in future periods. The valuation allowance increased by $212,559 during the year ended December 31, 2000. The valuation allowance did not change during the year ended December 31, 1999.

At December 31, 2000, the Company has net operating loss carryforwards of approximately $2,680,824 which expire in the year 2020. The Company has California net operating loss carryforwards for the year ended December 31, 2000 of $1,481,958 which expire through 2010. As a result of certain non-qualified stock options which have been exercised the tax benefit from the utilization of the net operating loss carryforward will be charged to additional paid in capital when, and if, the losses are utilized. The net operating loss may be subject to Internal Revenue Code Section 382 limitations.

No provision has been made for U.S. Federal and state income taxes or foreign taxes that may result from future remittance of the undistributed earnings of foreign subsidiaries because it is expected that such earnings will be reinvested overseas indefinitely. Determination of the amount of any unrecognized deferred income tax liability on these unremitted earnings is not practicable.

17. SEGMENT REPORTING:

The Company has identified its segments based upon its geographic operations. These segments are represented by each of the Company's individual legal entities: DPC, PD and DPL. Segment operations are measured consistent with accounting policies used in these consolidated financial statements. Segment information is as follows:

	December 31, 2000				
	DPC	PD	DPL	Eliminations	Totals
Revenues	$ 12,721,296	$ 15,302	$ 5,146,132	$	$17,882,730
Intersegment Revenues	$ --	$ 3,026,933	$ 483,394	$ (3,510,327)	$ --
Interest Income	$ 68,010	$ 1,742	$ --	$ (40,543)	$ 29,209
Interest Expense	$ 79,997	$ 2,021	$ 49,517	$ (40,543)	$ 90,992
Depreciation and Amortization	$ 303,890	$ 54,346	$ 117,751	$ --	$ 475,987
Income Tax	$ 80,000	$ --	$ 24,000	$ --	$ 104,000
Net Income(loss)	$ (526,264)	$ 179,333	$ 442,098	$ --	$ 95,167
Expenditures for Segment Assets	$ 133,972	$ 19,517	$ 65,425	$ --	$ 218,914
Segment Assets	$ 10,674,886	$ 180,624	$ 2,631,015	$ (1,321,475)	$12,165,050

	December 31, 1999				
	DPC	PD	DPL	Eliminations	Totals
Revenues	$ 8,864,412	$ 19,989	$ 6,469,617	$	$15,354,018
Intersegment Revenues	$ --	$ 2,150,000	$ 221,138	$ (2,371,138)	$ --
Interest Income	$ 128,106	$ 3,806	$ 12,936	$ (113,913)	$ 30,935
Interest Expense	$ 130,173	$ 7,098	$ 154,985	$ (113,913)	$ 178,343
Depreciation and Amortization	$ 161,489	$ 49,358	$ 289,844	$ --	$ 500,691
Income Tax Expense	$ (20,000)	$ --	$ 143,000	$ --	$ 123,000
Net Income	$ (67,139)	$ (70,437)	$ 171,003	$ --	$ 33,427
Expenditures for Segment Assets	$ 42,281	$ 51,687	$ 93,794	$ --	$ 187,762
Segment Assets	$ 9,251,925	$ 829,095	$ 4,924,991	$ (3,845,178)	$11,160,833

CONSENT OF INDEPENDENT AUDITORS

We consent to the incorporation by reference in the Registration Statement on Form S-8 of Digital Power Corporation of our report dated March 9, 2001, relating to the consolidated balance sheet as of December 31, 2000 and the related consolidated statements of income, stockholders' equity, and cash flows for the years ended December 31, 2000 and 1999, which report appears in the December 31, 2000 annual report on Form 10-KSB of Digital Power Corporation.

/s/ HEIN + ASSOCIATES LLP

Hein & Associates, LLP
Certified Public Accountants

Orange, California
April 16, 2001